NO. 78-1582

IN THE SUPREME COURT
OF THE UNITED STATES

STANLEY G. HARRIS, PETITIONER

v.

TOSHIO INAHARA, ROBERT L. KALEZ, LONGVIEW BOOMING CO., ROLAND BRUSCO, ALBERT STARR, JAMES A. WOOD, and GOLDEN KEY ASSOCIATES, a partnership

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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TABLE OF CONTENTS

COUNTERSTATEMENT OF QUESTIONS PRESENTED 1

STATEMENT OF THE CASE 2

REASONS FOR DENYING THE PETITION 5

CONCLUSION 17

FOOTNOTES 18

INDEX OF CASES

Affiliated Ute Citizens v. United States, 406 US 128 (1972) . . .11, 13

Chapman v. Forsyth, 2 How. 202, 11 L.Ed. 236 (1844) 8

Davis v. Aetna Acceptance Co., 293 US 328 (1934) 8

Fouchek et al. v. Janicek, 190 Or 251, 257, 225 P2d 783 (1950) 6

In Re Frazzetta, 1 F.Supp. 122 (W.D.N.Y. 1932) 6

In Re Harris, 458 F.Supp. 238 (1976) 9, 10

Starr v. International Realty, 271 Or 396, 533 P2d 165 (1975) 3, 7

Tetan Group, Inc. v. Faggen, 513 F2d 234, 239 (Cal 1975) 12

STATUTES

Bankruptcy Act §17(a)(4) 5, 9

Bankruptcy Reform Act of 1978, Section 523 15

ORS 83.340 6

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QUESTIONS PRESENTED

I

IS A JUDGMENT DEBT BASED UPON FRAUD, MISAPPROPRIATION OR DEFALCATION WHILE ACTING AS A FIDUCIARY UNDER OREGON LAW DISCHARGEABLE UNDER §17(a)(4) OF THE BANKRUPTCY ACT?

II

DOES THE RECORD SUPPORT THE FINDING OF THE DISTRICT JUDGE THAT "A

CAREFUL EXAMINATION OF THE EXISTING RECORD REQUIRES THE CONCLUSION THAT HARRIS WILLFULLY AND INTENTIONALLY CONCEALED MATERIAL FACTS FROM HIS PARTNERS AND THAT, IF THEY HAD KNOWN THE CONCEALED FACTS, THEY WOULD NOT HAVE AGREED TO THE TERMS OF THE CONTRACT" OR IN THE ALTERNATIVE, WHETHER IN A CASE OF NONDISCLOSURE, UNLIKE AFFIRMATIVE MISREPRESENTATION, AN INFERENCE OF RELIANCE ARISES IF THE CONCEALED FACTS ARE MATERIAL?

STATEMENT OF THE CASE

Petitioner Harris caused plaintiffs to form a partnership for the purpose of purchasing an apartment complex. As an inducement to plaintiffs, Harris joined the partnership and negotiated the purchase of the apartment complex as one

of the partners. Harris misrepresented to his partners that the purchase price was $1,010,000 rather than the actual price paid the seller of $907,500, failed to disclose that the seller was completely paid by the down payment, that Harris and his wholly-owned corporation were taking the sum of $102,500 as a commission and that the seller's interest in the sale contract was being acquired by Harris without any expenditure on his part. The Circuit Court for Washington County and the Oregon Supreme Court, which affirmed the Circuit Court in Starr v. International Realty, 271 Or 396, 533 P2d 165 (1975), denied Harris the right to the secret commissions and the vendor's interest in the contract. The Circuit Court found that Harris was:

> "* * * duty bound to make a full and complete disclosure of profits that he would either directly or indirectly receive from the transaction and that his failure to make a full and complete disclosure of profits that he would either directly or indirectly receive from the transaction * * * was fraudulent as to the other partners." Record on Appeal 25-26

Upon trial of the objection to Harris' discharge in bankruptcy, the parties submitted as evidence the entire record of proceedings before the Circuit Court for Washington County, including the testimony of 21 witnesses and 94 Exhibits and the opinion and orders of the Supreme Court of Oregon.

The bankruptcy judge held the judgment debt against Harris should be discharged.

The District Court reversed the determination of the bankruptcy judge

and held that the judgment debt of Harris should not be discharged. The Court of Appeals for the Ninth Circuit affirmed.

REASONS FOR DENYING THE PETITION

I

Petitioner does not contend that §17(a)(4) of the Bankruptcy Act is inapplicable to him because there was no fraud, embezzlement, misappropriation or defalcation by him. Defendant contends only that §17(a)(4) is inapplicable because his acts as a partner are not acts in "any fiduciary capacity" within the meaning of §17(a)(4). Whether a partner acts within a "fiduciary capacity" with respect to his partners depends upon applicable state law and the facts of the case.

The Oregon Supreme Court has held that a partner is in respect to his partners a "trustee and at the same time a cestui que trust." Fouchek et al. v. Janicek, 190 Or 251, 257, 225 P2d 783 (1950).

None of the cases cited by petitioner, except In Re Frazzetta[1/] 1 F. Supp. 122 (W.D.N.Y. 1932), arose in states which at the time of decision had adopted the Uniform Partnership Act under which there is a statutory duty to act as a fiduciary in regard to any transaction connected with the partnership.

Under applicable Oregon Law, ORS 83.340, the following statutory provisions necessarily become part of every partnership agreement:

> "Partner accountable as a fiduciary * * *.
>
> (1) Every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct or liquidation of the partnership or from any use by him of its property."

In Oregon the fiduciary relation created by statute exists from the inception of the partnership. In the case between these same parties in the state court the Oregon Supreme Court emphasized the fiduciary nature of the partnership relation under Oregon law:

> "When, as in this case a real estate broker undertakes to join as a member of a partnership or joint venture in the purchase of real property on which he holds a listing, he is also subject to the fiduciary duties of undivided loyalty and complete disclosure owed by the partner to another.

> Indeed, one of the fundamental duties of any partner who deals on his own account in matters within the scope of his fiduciary relationship is the affirmative duty to make a full disclosure to his partners not only of the fact that he is dealing on his own account, but all of the facts which are material to the transaction." Starr et al. v. International Realty, Ltd. et al., 271 Or 396, 403, 533 P2d 165, 168 (1975).

Davis v. Aetna Acceptance Co., 293 US 328 (1934), cited by petitioner, has no application. There the court merely held:

> "* * * A mortgagor in possession before condition broken is not a trustee for the mortgagee within the meaning of this statute, though he has charged himself with a duty to keep the security intact. * * *" 293 US at 334

In Davis the court referred to Chapman v. Forsyth, 2 How. 202, 11 L.Ed. 236 (1844) which held that under

the 1841 Act of Bankruptcy a factor does not act in a fiduciary capacity to his customer. Subsequent cases have followed the rule that trust imposed in a debtor in a commercial sense does not create the type of fiduciary relation required under Section 17(a)(4) of the Bankruptcy Act. Those cases have no application here, nor do partnership cases decided under laws different from those of Oregon.[2/]

Both the Oregon Supreme Court and the District Court in this case held that under Oregon law, Harris was in a fiduciary relation to his partners. The District Court held expressly that it was the kind of fiduciary capacity meant by Section 17(a)(4) of the Bankruptcy Act. The District Court said:

> "* * * This is a case of flagrant violation of a fiduciary obligation. I therefore

> hold that Harris was acting in a fiduciary capacity under the Bankruptcy Act when his debt to the plaintiffs was created * * *". In Re Harris, 458 F. Supp. 238, 243 (D. Or. 1976).

II

There is no question in this case that Harris did obtain money by false pretenses and false representations. The trial judge in the state court action said "that his failure to make a full and complete disclosure of profits that he would either directly or indirectly receive from the transaction * * * was fraudulent as to the other partners." ROA 25-26

The District Court found that:

> "* * * a careful examination of the existing record requires the conclusion that Harris willfully and intentionally concealed material facts from his partners and that, if they had known the concealed

> facts, they would not have agreed to the terms of the contract, and I so hold". In Re Harris, 458 F. Supp. at 242

Petitioner misconstrues the holding of the District Court and says that the District Court would "amend the Bankruptcy to dispense with the requirement of the proof of reliance." Contrary to petitioner's statement the District Court did not dispense with proof of reliance but expressly found by "a careful examination of the existing record" that there was reliance.

The District Court did go on, after its finding of reliance, to point out that, "in any event" this court has said:

> "Under the circumstances of this case, involving primarily

> a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of the decision * * *". Affiliated Ute Citizens v. United States 406 US 128, 153 154 (1972)

The District Court also referred to the decision of the Second Circuit where the court said:

> "* * * Unlike instances of affirmative misrepresentation where it can be demonstrated that the injured party relied upon affirmative statements, in instances of total non-disclosure, as in Affiliated Ute, it is of course impossible to demonstrate reliance, and resort must perforce be had materiality, i.e., whether a reasonable man would attach importance to the alleged omissions in determining his course of action.
>
> "In cases involving non-disclosure of material facts, even when coupled with access to the information, materiality rather than reliance thus becomes the decisive element of causation. * * * And determination of materiality allows

> logically an inference of reliance. * * *" Tetan Group, Inc. v. Faggen, 513 F2d 234, 239 (Cal 1975).

III

The Petition herein presents none of the special and important reasons for certiorari described in Supreme Court Rule 19.

There is no conflict with a decision of another court of appeals. There are in fact no decisions by any other court of appeals on the question of whether a partner made a fiduciary by state statute is acting in the fiduciary capacity mentioned in Section 17(a)(4) of the Bankruptcy Act. Nor is there any conflict in the circuits on the question of the method of showing reliance in case of false pretenses or false representation by nondisclosure. This

Court and the Second Circuit, as well as the Ninth Circuit in this case, have held that in a case of nondisclosures, the question becomes one of materiality and, as this court said, whether "a reasonable investor might have considered them important in the making of the decision." Affiliated Ute Citizens v. United States, 406 US at 153.

There has been no claim that an important state question has been decided in conflict with applicable state law. Nor has there been any assertion that there has been an important question of federal law which has not been, but should be decided by this court.

The issue concerning reliance in a case of nondisclosure, has been decided by this court. The issue concerning

whether a partner made a fiduciary by the state law is acting in the "fiduciary capacity" of Section 17(a)(4) of the Bankruptcy Act is not of the magnitude of importance requiring this court's attention. In the 81 years since the Bankruptcy Act of 1898 was enacted no other case on that point has reached a court of appeals and there has been only one other reported district court case which discusses the point.

On October 1, 1979 the Bankruptcy Reform Act of 1978, Pub. L. 95-598, will become effective. Under the new law exceptions to discharge are covered in Section 523. The language of both the present Section 17(a)(2) and Section 17(a)(4) have been expanded to include additional grounds for exception to

discharge. In addition to "false pretenses" and "false representation" Section 523(a)(2)(A) includes "or actual fraud." Section 523(a)(4) excepts a debt for "fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny" rather than "fraud, embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capactiy" as now stated in Section 17(a)(4).

There appear no "special and important reasons" for review of an exception from a discharge in bankruptcy of a debt by a partner who has defrauded his partners by secretly appropriating to his use substantial property which two state courts and two federal courts have held to be partnership property.

CONCLUSION

The petitioner presents none of the requirements for granting the writ. The case was decided below based upon Oregon law applied to the particular facts of the case, and upon a federal statute now repealed. The case raises no issues important beyond the instant matter. Certiorari should be denied.

DATED: May 11, 1979.

Respectfully submitted,

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FOOTNOTES

1/ In Re Frazzetta the Court denied a discharge to a partner who failed to account for money collected on behalf of the partnership. The discharge was denied apparently because Frazzetta "deliberately set out to defraud his partners" although the court refers to cases denying discharge for "willful and malicious" injury to property. The statement that a partner is not "within the definition of 'fiduciary capacity' as is contemplated by Section 17 of the Bankruptcy Act" is dictum and is contradicted by the next sentence which states that under New York law "a partner owes a fiduciary obligation to his partners". The obscure dictum of that case confuses rather than enlightens.

2/ Section 1 of the Act of August 19, 1841, 5 Stat. 440, prevented discharge of debts "created in consequence of a defalcation as a public officer; or as executor, administrator, guardian or trustee or while acting in any other fiduciary capacity." By application of the ejusdem generis rule "other fiduciary capacity" was held to "mean the same class of trusts" as those enumerated, "not cases of implied, but special trusts." Chapman v. Forsyth, 2 How 202, 208 L.Ed. 236 (1844). But the present statute

excepts from discharge debts "created by his fraud, misappropriation or defalcation while acting as an officer or in any fiduciary capacity." Now the statute refers only to "officer" and there is no "class" of officers so "in any fiduciary capacity" in the present statute is not limited to a "class" consisting of public officer, executor, administrator, guardian or trustee. Prior to the adoption of the Uniform Partnership Act, which expressly makes a partner a fiduciary, it could be argued that the fiduciary duties of a partner implied at common law were not of the class of "special trusts" enumerated in the 1841 Act. No case has discussed the differences between the language of the 1841 Act and the 1898 Act in this regard, but it appears likely that a court faced with this issue would decide that "any fiduciary capacity" in the present statute is broader than "any other fiduciary capacity" in the 1841 Act and would include the implied fiduciary obligation of a partner at common law.